A BRIEF HISTORICAL SKETCH

OF

# Canadian Banking and Currency

THE LAWS RELATING THERETO SINCE CONFEDERATION,

AND

*A COMPARISON*

WITH BRITISH AND AMERICAN SYSTEMS.

BY

W. J. ROBERTSON, B.A., LL.B.

*(Examiner in Political Economy, Toronto University)*

A PAPER READ BEFORE THE HISTORICAL AND POLITICAL SCIENCE ASSOCIATION OF THE UNIVERSITY OF TORONTO, FEB. 4TH, 1888.

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# Explanatory.

A short time ago, I was requested to prepare a brief outline of our system of banking and currency, for the benefit of the members of the Historical and Political Science Association of Toronto University. The object sought, was to give a few of the students of the University, interested in political economy, a general idea of the nature of banking, and, in particular, of Canadian banking and currency. It was suggested to me, that a comparison of our Canadian system with the British and United States systems, would add to the value and interest of the paper, and the suggestion, as the following pages will show, was partially carried out.

After the paper was read, several gentlemen, holding responsible positions, expressed a desire to have it issued in pamphlet form. In deference to that desire the present pamphlet appears.

In preparing this sketch, information and assistance were received from several gentlemen of banking experience, and, in particular, from H. W. Darling, Esq., President of the Bank of Commerce; D. R. Wilkie, Esq., Cashier of the Imperial Bank; and W. L. Trenholm, Esq., Comptroller of the U. S. Currency To these and other gentlemen, who responded so promptly to my requests for information, I wish to express my appreciation of their kindness.

W. J. ROBERTSON.

St. Catharines, March 8th, 1888.

# Canadian Banking and Paper Currency.

AT the request of your President I have prepared a paper on the leading features of Canadian Banking and Paper Currency. No limits have been assigned me, so that in selecting some parts of the subject for fuller discussion than others, I have been guided by what it may be possible to overtake in a limited time, and by what may be useful to students desiring a general knowledge of the principles of the system of banking existing in our land.

Modern systems of banking have much in common, and this is specially true of what may be termed English systems, including under this designation those prevailing in the United States and British Colonies, as well as those in Great Britain and Ireland. In discussing, then, Canadian banking and currency, we cannot well avoid referring frequently to British and American systems, and it is desirable that these references should take the form not only of explanation, but of comparison. In fact, our Canadian banking system, like our Canadian political constitution, is a compound of British and American elements, with a few native ingredients intermingled, and rendered necessary by our peculiar circumstances.

By way of preface, I may observe that the subject of banking is not identical with that of currency. A bank may issue its own notes in the form of a currency, but it is not necessary that it should do so. Nevertheless, it must be admitted that in Canada and the United States the majority of banks have been wont to issue their own notes, and the effect of the practice has been to create a general impression on the mind of the

American people that a bank's chief function is to provide a currency. Indeed, so closely are banking and currency connected in our commercial life and habits, that it would be utterly impossible to give a clear idea of the one without treating of the other.

## WHAT IS A BANK?

A bank is an institution which deals in money and debts. It buys debts with its own credit, and thus creates new debts. It borrows the capital not needed by one man, and lends it to another who does need it. It thus transfers capital from place to place, and from person to person. Its disposable means are:—The capital paid in by the shareholders or partners, the deposits of its customers, the amount of its own notes it can keep out in circulation, and the money in the course of transmission through it. It uses these means in discounting bills, in making loans, in the purchase of Government and other securities, and in maintaining in its till a sufficient quantity to meet current demands. It does not necessarily, in discounting bills and making loans, use money or bank notes. A very large part of the business of commercial centres is carried on without the intervention of a single bank note or a particle of gold or silver coin. This is accomplished by the extensive use of cheques, bills of exchange, drafts, and book credits. To take a familiar case by way of illustration:—A sells 1,000 bushels of wheat to a merchant B for $750. B gives A a bill or note, payable in one month. This note A takes to a banker *C* and discounts it, but instead of taking away the present worth in bank notes or coin, he leaves it as a deposit in the bank. If A keeps an account with *C*, the proceeds of the note will be placed to A's credit in the books of the bank. A can now draw on the bank for any sum he wishes short of the amount to his credit. If A wishes to make a payment he will not go to the bank and get coin or bank notes, but will give a cheque to his creditor instead, and when this cheque is presented for payment by, say D, it may in turn be placed to the credit of D's account in the bank. If now we go back to B, whose bill becomes due in one

month, we find that another saving of bank notes or money may be made. When the banker *C* demands from B the payment of his bill, B may give him a cheque on his own banker for the amount. This cheque will be presented to B's banker by *C*, and in all probability *C* will find that B's banker holds a cheque of an equal amount against him. These two cheques will then be set off, one against the other, and no money will pass. The cheque of B's banker may have been originally based on the sale of a quantity of lumber to a customer of *C*, so that we find, in the long run, wheat has been exchanged for lumber. The result of this analysis of a very simple transaction has been to show that business is largely carried on by means of the instruments of credit which a bank employs. If we imagine such a transaction as I have sketched to be multiplied and varied many thousand-fold, and not two only, but many banks engaged in the work of discounting bills, issuing cheques, granting book credits, making loans, and cancelling their cheques against each other by means of a clearing-house, we will to a certain extent realize the enormous saving made not only in coin, but also in paper currency, by our modern banking systems. In fact, the transactions performed by means of cheques and book credits, drafts, etc., very far exceed those carried out by paper and metallic currency combined. In London over ninety per cent. of a banker's transactions take place in cheques and bills. A bank, however, does frequently pay its cheques with its own notes, and often makes advances in the form of loans in the same fashion. The point to be noted in connection with such advances is that the bank is using a general form of credit for a special one. The bank, by issuing its notes, is lending its credit to the borrower, and thus enabling him to secure from the public wealth or capital which his own credit at the time will not enable him to obtain. If a banker pays a cheque with his own notes he merely exchanges one instrument of credit for another. To the public and banker, however, it makes a considerable difference; for, inasmuch as a bank note is likely to remain longer in circulation than a cheque, it will give the banker a larger profit, and will

accomplish far more in the exchange of commodities. Cheques and drafts, or inland bills of exchange, are used to transfer capital or wealth from one part of a community to another; foreign bills of exchange transfer capital to foreign countries.

Bankers have found by long experience that of the large amounts deposited with them, a comparatively small percentage is demanded back from day to day. Also, of the notes they issue, the public generally keep the bulk in circulation, so long as no excessive issues take place and the general management of the bank is judicious. Under these normal circumstances the banker finds he may employ nearly all the capital at his disposal in loans, discounts, and other banking transactions, reserving a small quantity to meet any demands that may arise for a withdrawal of deposits or redemption of notes. One of the most important questions, then, in connection with banking is, What regulation or regulations should be made by the State to control banks in the management of their business, so as to secure noteholders, depositors and other creditors from loss in case of bank failures. Should the State interfere at all in the management of a bank, any more than it interferes with manufacturers or wholesale merchants in the management of their business? There are writers on banking and currency that oppose State interference with the management of banks; but the almost unanimous opinion of the best authorities is that experience has shown that the effects of banking, whether for good or evil, on the prosperity of a State, are too important and far-reaching to allow individual enterprise to pursue its own methods without Government control. In some countries, especially in Scotland, banking is conducted with great caution and sagacity, and few losses have resulted from allowing a great latitude in the private management of these institutions. In others, however—notably in the United States, prior to the introduction of the National Bank system—free banking was an intolerable evil, owing to its reckless management. Bankers are like other business men—fallible, and liable to be over sanguine, to make injudicious loans, to maintain inadequate reserves, and to fail in reading the signs of coming commercial

storms and panics. The management of a bank in times of national prosperity, and under normal conditions of trade, is an easy matter, and little danger exists in maintaining a small reserve. It is another thing to pilot a bank through a crisis, when the fears of the public are unreasonably excited, when failures of commercial houses are daily taking place, and credit is scarce. It is against these frequently-recurring crises and panics that legislation for banks is required. To attempt to describe the various devices that legislators have called into existence to give banks and paper currency a secure place in the public confidence would be utterly out of the question. Those wishing an excellent summary of the different methods of regulating bank issues would do well to consult Prof. Jevons' admirable work on "Money." The principal methods in English systems of securing a currency are: (1) The maintenance of a proportional reserve; (2) a minimum reserve; (3) the deposit of Government securities with the State; (4) a reserve of coin equal in amount to notes issued; (5) no reserve at all, but liability of shareholders, either limited or unlimited; (6) the issue of all notes through banks by the State; (7) a maximum issue. In some countries two or more of these systems are combined. It will be part of our task, now, to find out what principles have guided Canadian legislators in the establishment and control of our banking and currency system.

Before proceeding to an examination of our system of banking and currency, it will be desirable to give a brief historical sketch of its growth and development since the confederation of the Provinces. The different kinds of banks in the old Province of Canada may be classified as follows:

1. Private banks—that is, banks the property of individuals or partners associated together, subject to the laws applicable to ordinary co-partnerships.

2. Banks incorporated by royal charter or legislative enactments. These were mainly joint stock in their nature.

3. Savings banks incorporated according to legislative enactments.

Of these banks the second kind alone was empowered to

issue *notes* or paper currency. The charters of these banks of issue differed in important details, but they all contained provisions which made it necessary that a deposit of public securities with the Receiver-General should take place before notes were issued, and that notes could not be circulated in excess of the securities deposited, or that the aggregate issue should be limited by the paid-up capital. If notes were issued in excess they were to be covered by gold and silver or debentures. These seem to have been the only securities possessed by the public that bank notes would be redeemed when presented for payment, except the security known as the *double liability* of shareholders. Each shareholder was held liable for double the par value of the stock he held in the bank.

In the session of 1866-67, the Government took to itself power to issue Provincial notes to the amount of $8,000,000; $5,000,000 being for general, and $3,000,000 for special purposes. In consequence of this legislation $8,000,000 of notes were engraved and prepared for issue—the greater portion being actually issued. In 1868, after the consummation of Confederation, an Act was passed declaring these Provincial notes to be Dominion notes, and redeemable as such. Power was also taken under this Act to enter into arrangements with the banks for the surrender of their right to issue, the banks to be recouped by an annual payment of not more than five per cent. on the amount of their issues surrendered, until the expiration of their charters. The Government bound itself to maintain, as a reserve for the redemption of their notes, twenty per cent. of the amount in circulation, so long as that amount did not exceed $5,000,000. For any sum in excess of $5,000,000 twenty-five per cent. was to be held; but the total issue must not exceed $8,000,000. Government debentures were to be held by the Receiver-General for the amount not covered by specie, and these debentures could be disposed of if necessary in order to redeem the Dominion notes. We have in this legislation the initial steps taken in the direction of a national currency. Two years later this Act was repealed so far as it gave power to the Government to make arrangements with the banks for

the surrender of their right to issue. Also, the limitation of the amount of Dominion notes to $8,000,000 was removed, and the maximum amount that could be put in circulation placed at $9,000,000. But the issue was carefully guarded by the following restrictions:

1. It must be secured by debentures and specie equal to it in amount; the debentures not to be more than eighty per cent. of the amount held for redemption.

2. Not more than $1,000,000 at one time, and at intervals of not less than three months, could be issued.

3. No increase in the issue could take place until the Receiver-General held specie equal in amount to twenty-five per cent. of the aggregate of the increase and of the debentures already held by law.

4. The maximum amount of issue, $9,000,000, could not be reached unless the Receiver-General held specie to the amount of $2,000,000.

5. Monthly statements of the notes in circulation, and the specie and debentures to cover them, must be published by the Receiver-General.

In the same session a Banking Act was passed, its purpose being to secure a measure of uniformity in the laws relating to the different banks. The principal clauses in this Act requiring notice are as follows:

1. The amount of notes intended for circulation issued by a bank, and outstanding at any time, must never exceed the amount of the unimpaired paid-up capital, and no note must be for a less sum than $4.

2. The bank must always hold, as nearly as may be practicable, fifty per cent. of its cash reserves in Dominion notes, and the proportion of such reserves in Dominion notes must never be less than thirty-three and one-third per cent.

3. *Double liability* of shareholders was continued.

4. Banks were to be exempt from taxation on their notes in circulation. There had been a tax of one per cent.

5. Only chartered banks were allowed to issue notes, an exception being made in favor of the Halifax Banking Co., which was allowed to issue until 1874.

6. Banks could not commence business until $200,000 capital was paid up.

7. Twenty per cent. at least of the subscribed capital must be paid each year after banking has commenced.

8. Banks must not make loans or grant discounts on the security of their own stocks.

9. No dividend exceeding eight per cent. must be paid until there is a rest of twenty per cent. of capital.

10. Discount to directors must not exceed one-twentieth of total of discounts made by the bank.

11. Monthly returns of assets and liabilities, according to a prescribed form, must be made by each bank.

12. Bank charters were continued until 1881.

13. The Bank of British North America must not issue notes of a less denomination than $4 after 1871.

In 1871 further legislation in the direction of uniformity took place. Banks were allowed to establish branches and increase their capital stock. They were not to commence business until $500,000 capital had been subscribed and $100,000 paid in, which sum had to be increased to $200,000 within two years. Discounts to directors were to be regulated by by-law (a change for the worse). Loans on lands and tenements were not permitted. Mortgages could, however, be taken as collateral security. Savings banks could be established, but could not issue notes.

The Act of 1870 was repealed in 1872, so far as it related to issuing notes beyond $9,000,000. The specie to be held for any excess above $9,000,000 was fixed at a maximum of thirty-five per cent. In 1875 a Dominion Notes Act permitted an issue of $12,000,000. It was enacted that if the issue exceeded $9,000,000, but fell below $12,000,000, the amount of the excess above $9,000,000 must be secured by a specie reserve of at least fifty per cent. Any excess above $12,000,000 was to be covered by an equal amount of specie.

Banking legislation now ceased until 1880, when it became necessary to renew the bank charters which expired in 1881. Meanwhile, Canada had made a sweeping change in her fiscal

system. Protective duties had, in 1879, taken the place of a revenue tariff, as the result of the election of 1878. It was quite natural that the interest and excitement aroused by a long and bitter controversy over the relative merits of free-trade and protection, should extend to other questions of national finance. Hence, no sooner had protection triumphed, than many of its votaries began to agitate for a national currency. For a time the agitation seemed on the fair road to success, for it was urged, with considerable plausibility, that a national policy of protection would not be complete without a national currency.

The advocates of a national currency were not at all united in their demands. The more moderate and conservative desired a currency issued by the Government through the banks and redeemable in specie on demand, all bank issues to cease. The great majority, however, of the currency doctors wished a circulating medium not redeemable in specie, but legal tender for taxes. The basis of such a currency was not settled—some advocating one thing, some another. There was, as might be expected, for a brief period, considerable alarm in business and banking circles, and this alarm was not lessened by the measures relating to banking and currency, introduced by Sir Leonard Tilley in the Session of 1880. The whole drift of the changes then introduced, seemed to be in the direction of "rag-money," and sober men strongly suspected the Government of giving a sop to the advocates of an inconvertible currency. The changes, as we now look back, were not of a very radical nature, consisting in the main, of an extension of the issue of Dominion notes, and a lessening of the ratio between the Government reserve and its note circulation. A more detailed account, however, of these measures is necessary, as no change of any importance has since taken place, and their provisions, which were ably and exhaustively debated in Parliament, now regulate in the main our system of banking and currency.

The resolution relating to Dominion notes was as follows:

"That it is expedient to provide that the amount of Dominion notes issued, and outstanding at any one time, may be increased

to $20,000,000, provided that the Finance Minister shall always hold for the redemption of such notes an amount in gold, or in gold and Dominion securities guaranteed by the Government of the United Kingdom, equal to no less than twenty-five per cent. of the total amount of such notes then outstanding, and that at least fifteen per cent. of the total amount of such outstanding notes shall be so held in gold."

The change made by this resolution was two-fold:

1. It authorized an increase in the Dominion note circulation from $12,000,000 to $20,000,000.

2. It lowered the percentage of gold reserve to fifteen per cent. on the total issue. The practical effect was to reduce the gold reserve from about $4,000,000 to a little over $1,800,000 on the notes then outstanding, thus leaving over $2,000,000 of gold available for other purposes. If the Government should succeed in increasing their issues to $20,000,000, the gold reserve would still be less than that previously required, and the great advantage would be gained of obtaining an additional loan of $8,000,000 from the public.

As a complement of this resolution, the Banking Act was amended the same session in several important particulars.

To ensure an increase in the issue of Dominion notes, banks were now compelled to keep forty per cent. of their reserves in Dominion notes, and were not allowed to issue their own notes of a less denomination than $5. The minimum reserve in Dominion notes prior to this was thirty-three and one-third per cent.

*Notes were made a* FIRST *charge on assets.* Dominion notes in denominations of $1 and $2, to the amount of $50, could be demanded from a bank by anyone receiving payment of that or a greater sum. This clause also had for its object the increase of Dominion notes in circulation. Banks were given a privileged lien on stocks and dividends for debts and overdue accounts. What was then considered by the Finance Minister as an important piece of legislation, but which has not met public expectation, was the introduction of a clause rendering it imperative on banks to make more detailed monthly returns of their liabilities and assets.

Having thus imperfectly and briefly sketched the principal changes, from time to time, made in the laws relating to our banking and currency, I will now endeavor to describe the prominent features of the system as it stands at present.

In the first place, it is to be noticed that Canadian banks, as a rule, are banks of issue, and as such derive their privileges from the Dominion Parliament, not from the Local Legislatures of the different Provinces. The right to issue their notes is given by charter—the present charter expiring in 1891.

In Canada there are few private banks, most of our banks being joint-stock in their nature. The distinction between a private bank and a joint-stock bank, consists mainly in the facts that the number of partners in a private bank is generally small, and the liability of each partner unlimited. Each partner, too, may have a share in managing the business of the bank, and the bank is liable for contracts and engagements entered into with the public, by any or all of its partners, as partners. Joint-stock banks, on the other hand, may have any number of partners, and the liability of each partner or shareholder is generally limited. The business of such banks is managed by a board of directors, elected by and from the shareholders, and the bank is bound only by such engagements as are made by the directors and managers. The withdrawal or insolvency of one member of a private bank lessens the capital of the bank, but the shares of a joint-stock bank are transferable, and the partners may be constantly changing, and yet the bank continues its corporate existence, and retains its capital unimpaired. Private banks in Canada are not allowed to issue notes, this right is confined to joint-stock banks alone.

Again, the right of a Canadian bank to issue notes, or paper currency, is restricted to the amount of its unimpaired paid-up capital, and no note can be issued of a less denomination than $5. Notes of a smaller denomination are issued by the Dominion Government. Our currency, then, is of a mixed character—partly national, partly what may be termed *corporate*. Bank notes are not legal tender—Dominion notes are. Of the whole amount of our paper currency, by far the greater portion con-

sists of bank notes, Dominion notes being used chiefly for small payments, change, and bank reserves.

It may be asked what security is furnished by banks to note-holders and depositors? There is a common impression abroad that a cash reserve of twenty-five to thirty-three and one-third per cent. of the amount of notes in circulation must be kept by a Canadian bank to meet all demands for coin. This is a mistake. The law does not compel a bank to maintain any reserve whatever as a security for note-holders and depositors. It must keep forty per cent. of its reserves in Dominion notes; but this does not fix the minimum amount of the total reserve. Public opinion, however, is such that a bank with a reserve of less than twenty-five per cent. is looked upon with suspicion, and its credit is likely to suffer in consequence. As banks are compelled to make monthly returns to the Government of their circulation and deposits, and also of the amount of their reserves, any bank attempting to lessen its reserve below a certain minimum percentage of its circulation would speedily lose public confidence. Note-holders are secured (1) by the law forbidding a bank to issue notes greater in amount than its unimpaired paid-up capital, (2) by making shareholders liable for double the amount of the par value of their shares, (3) by making the redemption of notes the first charge on the assets of the bank. The wisdom of the clause giving note-holders the first lien on assets has often been called in question. It is contended that it is unfair thus to discriminate against depositors and other creditors. Besides, the tendency of this law is to make depositors, if suspicious of the solvency of the bank, draw their deposits in the shape of notes, in order to be on a footing of equality with the note-holders, and, by so doing, intensify public suspicion. (See Note A, Appendix.) Depositors, however, have not been wholly overlooked in the Banking Act. Realizing the fact that one of the great dangers incurred by a bank is the locking up of its banking capital in securities not readily realizable, our legislators have prohibited the loan of money on the security of real estate—that is, on land and tenements. Mortgages cannot be taken as security for a loan,

although after the loan has been made they can be taken as collateral security. Nor can a bank hold any real estate for more than seven years, except such as may be required for banking uses. As a further precaution in the interests of the public, loans cannot be made on the security of stocks and dividends; but a bank has the first lien on them for debts and over-due accounts. The whole tenor of these restrictions is to prevent investments not readily realizable being made, and to discourage stock-gambling. Still further to ensure confidence, banks have to make monthly statements to the Government, and these statements must exhibit in considerable detail their liabilities and assets.

If a bank suspends payment for ninety days it loses its charter, and its affairs are wound up. It can no longer issue notes or contract liabilities. There are a number of other regulations of considerable importance affecting the management of a bank. Such are those prescribing the amount of capital that must be paid up before banking can commence—the qualification and election of directors, discounts and loans to directors, etc.

As already stated, our currency is partly national, for the Act of 1880 allows the issue of Dominion notes to the amount of $20,000,000. The notes are secured by coin and Government debentures. The coin must be, at least, fifteen per cent. of the issue; and of the Government debentures, ten per cent. must be guaranteed by the Imperial Government. The guaranteed debentures are considered as good as gold, so that it is claimed our Dominion currency is secured by a cash reserve of twenty-five per cent.—one sufficient for all probable demands.

Dominion notes obtain circulation chiefly through the banks, and constitute a considerable portion of their reserves. It is in the interest of a bank to issue as few of these notes as possible, for they must be purchased with gold or specie before they can be issued. To prevent the suppression of the circulation of its notes, the Government retains the right to make issues for sums less than $5, and compels a bank to pay as much as $60* in

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* In 1882, amount was increased from $50 to $60.

Dominion notes of $1 and $2 or $4, if the person to whom payment is made should so demand. Of course, the Government could issue its notes directly, by paying its indebtedness to contractors, Indian subsidies, and other claims against it, in Dominion currency; and, no doubt, in a very small measure, Dominion issues do thus take place. The great bulk, however, of Dominion notes are issued to banks, which hold them as a reserve instead of coin. Over $8,000,000, out of a total issue of some $15,000,000, is thus retained.

Let us now proceed to make some comparisons with the systems of banking and currency in Great Britain and the United States.

## BRITISH BANKING.

English banking, so far as it relates to currency, has for its basis the Bank Charter Act of 1844. This Act had for its principal object the regulation of the currency, so that the amount at any time in circulation should correspond exactly with what would be in existence were there a currency composed entirely of gold and silver coin. If gold were plentiful, the currency would increase, if scarce, there would be a corresponding diminution of the amount in circulation. To attain this end, the Bank of England was divided into two departments, an Issue Department and a Banking Department. The Banking department was allowed to issue £14,000,000 of notes on certain securities, the greater portion of which was a debt due the Bank by the Government. All issues above this amount could take place only by paying into the bank an equal amount of gold. The Issue Department was restricted to giving notes for gold, and gold for notes—this was and is its sole function. In fact, the Issue Department is a department of the Government, and as such is the issuer of a national currency. The Act also provided that a large portion of the profits arising from the circulation of the issue of £14,000,000 should go to the State.

At the time of the passing of this Act, there were a large number of joint-stock and private banks issuing notes on their

own credit. Rightly or wrongly, these banks were considered to have failed in providing a sound currency, and were charged with issuing their notes injudiciously, thus causing inflation, speculation, and a host of kindred evils. It was not deemed prudent to take away at once from these banks their right to issue notes; but their circulation was restricted to what the average had been during the twelve weeks preceding the passage of the Act. No new banks of issue were permitted to be established. It was expected that many of the existing banks would, in time, surrender their right to issue, or become insolvent. In such cases it was provided that their circulation should lapse, and the Bank of England might then, if so disposed, issue uncovered notes in excess of £14,000,000, to the extent of two-thirds of the lapsed circulation.* The profit from this increased circulation was to go to the Government. As a consequence of this regulation, the Bank of England is now entitled to issue nearly £15,000,000 of notes, uncovered by gold.

For a long time, in England, joint-stock banks were not permitted by law to issue their own notes—banks issuing notes being limited to those having not more than six partners. Finally, in 1826, permission was given to establish banks of issue with more than six partners, but these banks were not to be established within sixty-five miles of London. In the same year £1 notes were suppressed, and the lowest denomination that could be issued fixed at £5.

Banking in Scotland differs in some important respects from English banking:—

1. Scotch banks are all joint-stock banks.
2. They are nearly all banks of issue.
3. They generally have branches. Most of the private banks, and many of the joint-stock banks in England have no branches.
4. Scotch banks issue notes of a denomination as low as £1.

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* Note.—It was supposed that banks maintained a reserve of at least one-third of their circulation, so that if a bank's circulation should cease, the amount of currency would be diminished by two-thirds of the lapsed circulation.

There are other differences which time will not permit me to mention.

Scotch banking is regulated by an Act passed in 1845. By this Act the right to issue is confined to such banks as exercised this right in the year preceding May, 1845, and the amount each bank is entitled to issue, uncovered by gold, is limited to the average amount in circulation during the same year. Scotch banks, however, unlike English banks, can issue in excess of this amount, provided each note in excess is covered by an equal amount of gold and silver coin. Bank of England notes are not legal tender in Scotland—they are in England, save at the bank itself.

It is evident from this brief outline of English and Scotch banking, that few points of similarity exist between the Bank of England as a bank of issue, and our Canadian banks. The Issue Department of the Bank of England should be recognized by law as a bureau of the Treasury, and then it would be clearly seen by the public to be what it really is, an issuer of an English national currency.

Comparisons, then, with English and Scotch banking institutions, to be of much value or interest, must be made with the private and joint-stock banks. As to points of similarity between our banks and British banks, we may notice that—

1. All Scotch, and many English, banks are joint-stock.
2. They are limited in their issues.
3. They are not compelled by law to keep any cash reserve.
4. Scotch banks, like Canadian banks, have numerous branches, and issue notes of low denominations.

The following are some of the principal differences:—

1. In England there are numerous private banks of issue. In Canada there are none.

2. English and Scotch banks are limited in their issues in a different way from Canadian banks. Canadian banks are limited by the amount of their unimpaired paid-up capital. English banks cannot increase their issues under any circumstances, while Scotch banks can do so only by covering the increase with an equal amount of coin.

3. English banks cannot issue notes of a lower denomination than £5.

4. The shareholders of British banks have an unlimited liability with respect to the notes in circulation. Canadian shareholders a double liability.

From this comparison it will be readily seen that our system of banking considerably resembles the Scotch, and there can be little room for doubt that Scotch enterprise and influence are felt as strongly in Canadian banking as in Canadian politics. It would, however, be well for Canada if the judiciousness which characterizes Scotch banking were equally manifest here. The excellent results of this judiciousness are seen in the confidence with which bank notes are taken in Scotland, and the consequent popularity of its paper currency.

## AMERICAN BANKING AND CURRENCY.

Turning away, now, from British systems, let us briefly examine that of our neighbors, the people of the United States. Here we find a truly national currency, and no currency that is not national. Previous to the civil war the United States had a great variety of banks of issue, holding their charters under State Laws, and issuing their notes with the greatest license. In 1862, the financial necessities of the Northern States compelled them to issue a national paper currency, which was not immediately convertible into specie, and which, in consequence of over-issue and lack of confidence in its ultimate redemption, was for a time considerably depreciated. But in 1879, the United States Treasury began to redeem its notes in coin, and ever since United States notes or greenbacks have been on a par with gold. These notes were made legal tender for all debts, public and private, except duties on imports and interest on the national debt. In 1863 it became necessary to organize the banks on such a basis as would make them instruments in the hands of the Government in floating its bonds and circulating its notes. After much discussion the Free Banking System was abolished, and all banks of issue were

compelled to become national banks. The new system, which in all its essential features still exists, may be described as follows:

An official, called the Comptroller of the Currency, is appointed in connection with the Treasury Department, and placed under the authority of the Secretary of the Treasury. Associations formed for banking purposes must satisfy the Comptroller that they have met the requirements of the law relating to the formation of banks, after which he is authorized to issue notes to them in amounts not exceeding ninety per cent. of the par value of the United States bonds they deposit with the Treasury as security for the redemption of the notes so issued. Banks with a capital not exceeding $150,000 are compelled by the Act of 1882 to deposit bonds equal in amount to one quarter of their capital. No note is issued by the Comptroller until the necessary bonds are deposited. In addition, five per cent. of the amount of notes in circulation must, in the form of United States notes or greenbacks, be deposited with the Treasury to take up such bank notes as may be presented to the Treasury for redemption. Having made this deposit, a bank is not compelled to maintain any reserve whatever to redeem its notes in circulation, but must keep a reserve in United States notes of fifteen per cent. of its deposits, of which the five per cent. deposited with the Treasury is considered a part. In certain large centres, such as New York, Philadelphia, Boston, and Chicago, banks must keep a reserve of twenty-five per cent. of their deposits. (See Note B, Appendix.) An exception to these rules is made in the case of banks which are organized to issue notes redeemable in gold. These gold banks, as they are called, must maintain a cash reserve of at least twenty-five per cent. of their outstanding circulation, and must deposit with the Treasury United States bonds, for which they are entitled to receive notes to the extent of eighty per cent. of the par value of the bonds.

National bank notes, when issued to the banks, have printed on them the statement that they are secured by United States bonds deposited with the Treasury, so that these notes

bear on their face a certificate of their convertibility and soundness. Still further, to ensure their ready circulation, these notes are stated to be legal tender for all public dues, except duties on imports, interest on national debt, and redemption of United States notes.

A distinction must, however, be drawn between United States notes and national bank notes. The former are called "legal tenders," and are such for all debts, public or private, except duties on imports and interest on national debt. Since cash resumption took place in 1879, United States notes are frequently taken in payment of customs, and are now treated by the Treasury as equivalent to coin. On the other hand, bank notes are not made legal tender except for public dues. Bank notes were primarily redeemable in United States notes, which in turn were redeemable in specie; but now no distinction is drawn between specie and United States notes by the Treasury. Bank notes, therefore, may be redeemed immediately in specie.

As a matter of fact, bank notes are just as sound, if not sounder, than United States notes, although for various obvious reasons they are more frequently redeemed

Besides these two kinds of paper currency, there is now in circulation two other kinds of paper currency, viz.: gold certificates, and silver certificates. These are in form much like United States notes, and bear upon their face the promise to pay on demand a certain number of gold and silver dollars respectively. They are issued in return for the deposit of gold and silver with the Treasury; and thus resemble very strongly Bank of England notes, which are paid out by the Issue Department in exchange for a deposit of gold.

No notes are issued by banks working under State charters, simply because the United States law imposes a tax of ten per cent. on all such notes in circulation. This tax effectually prevents them from being issued.

The Government of the United States pays the Banking Associations interest on the United States bonds deposited with it as security, and in return, collects from the banks each half year, one-half per cent. of the average of the amount of their

notes in circulation ; one-fourth per cent. of the average of their deposits, and one-fourth per cent. duty on the capital stock in excess of the amount invested in bonds.

The leading features of the American system can, then, be outlined in a few words. The banks receive their notes from the United States Treasury in return for deposits of United States bonds bearing interest; the bonds being greater in amount than the notes they cover. The Treasury is pledged to redeem these notes, so that note-holders are perfectly secure. At any time bank notes are redeemable in United States notes, which are themselves redeemable in gold or silver. The banks lose a considerable portion of the profit on their circulation, but are partially recouped by receiving interest on the bonds they have deposited with the Treasury. On the other hand, the Treasury gains a small profit on the bank circulation, deposits and capital, in the form of a small tax. From this sketch, it cannot fail to be observed that our currency, so far as it consists of Dominion notes, seems to owe its origin to the influence of American legislation and public opinion upon our own. So far back as 1866-67, we find a proposal made to issue Provincial notes, and in 1868, our legislators gave power to the Government to make arrangements with the banks for the surrender of their issues. Step by step, the amount of Dominion notes permitted to be issued, has been increased, until now we have reached a maximum limit of $20,000,000. A marked difference, however, exists between the relations our banks bear to the Government, and those existing between American banks and the Treasury Department. American banks receive interest on the bonds they deposit, Canadian banks must purchase the Dominion notes they issue with gold or equivalent specie. Here the advantage is entirely with the United States banks. On the other hand, these banks must pay a tax on their circulation, deposits, and perchance part of their capital. Canadian banks pay no tax whatever to the Dominion Government on their circulation, deposits and capital. But, whatever advantage the United States national banks possess over Canadian banks, by reason of the interest they receive on the bonds they

deposit, is more than neutralized by the liberty enjoyed by Canadian banks to issue their own notes. And, as already stated, the amount of notes of Canadian banks in circulation, far exceeds that of the notes of the Dominion. From the standpoint of the bankers, then, it would seem that our system is preferable to the American. If, however, we look at the two systems from another standpoint, that of the good of the public, it is not so apparent that we have reason to congratulate ourselves on the wisdom of our banking legislation. United States currency, whether greenback or national bank note, possesses the public confidence in a measure ours cannot pretend to enjoy. No one questions for one moment, the ability of the United States Treasury to redeem its notes or those of the national banks. It is a pity that we cannot say the same of our banks. Although it seldom happens that a Canadian bank cannot sooner or later redeem its notes in full, yet the fact that insolvencies are by no means uncommon, and that holders of the notes of insolvent banks are frequently compelled to, or do, part with them at a sacrifice, has left an impression of insecurity on the minds of many people which it would be well for our legislators to remove.

In addition to note-holders, there is another important class of the community whose interests must be considered, viz., the depositors. Depositors in Canadian banks, in the case of insolvency, have to take what they can get after note-holders have been satisfied. American banks must keep a reserve to partially cover their deposits; also, all the resources of the bank, except the deposited bonds, are available for depositors and other creditors, since note-holders are secured by the bonds deposited with the United States Treasury. Canadian banks are not compelled to maintain any reserve to cover deposits, although the demands of safe banking, and the force of public opinion, generally cause them to keep a small reserve. Experience, however, has shown that the shareholders and depositors of Canadian banks only too frequently suffer heavily from bank failures.

In some respects our banking laws are almost identical with

those of the United States. There is the same double liability of shareholders; the same first lien on assets in favor of note-holders, and very much the same restrictions against loans to directors, and on unrealizable security. The first lien on assets referred to is practically an unnecessary piece of legislation, so far as American banks are concerned. When a bank fails, if its circulation exceeds the deposits of lawful money it has made with the Treasusy to redeem its notes, a sufficient amount of its bonds are sold to make up the deficiency. Should the sale of all the bonds it has deposited not prove sufficient, then the Treasury can fall back on its first lien on assets. If, however, we consider that United State bonds are considerably above par, and that the circulating notes of a bank can never exceed ninety per cent. of the par value of the deposited bonds, it is at once seen that the first lien clause is not required. In Canada, on the other hand, it is very frequently needed, and provides one of the best securities for the redemption of bank notes.

Thus far the comparison has been favorable to the American system of banks. There is, however, another side of the question worth considering. Most American banks, unlike Canadian and Scotch banks, have few branches and small capitals. Out of 3,049 banks recently reported by the Comptroller of the Currency, 2,150 have a capital of $150,000, or less; that is two-thirds of the American banks have capitals so small as to render it inevitable that numerous failures must take place through financial mismanagement, or on the occasion of any serious disturbance in the trade of the community. Statistics show that bank failures in the United States are much more numerous than in Canada, although the losses are necessarily confined to depositors, shareholders and creditors, other than holders of bank notes. Again, the present basis of American bank issues must be very soon radically changed, if the banks are to continue to issue notes. United States bonds are no longer a profitable investment for banks, owing to their high price, and the low rate of interest they bear. Year by year witnesses a rapid decrease of national bank notes, and a corresponding increase

of a paper currency known as the "silver certificate." Besides, the United States Government, owing to the high rate of taxation on imports, is enabled to redeem its bonds in large quantities each year, thus cutting away the basis of the United States national banks with alarming rapidity and certainty. (See Note C, Appendix.)

The question often arises, why we have not adopted a national banking system, and a national currency. It cannot be said that this is a subject of merely speculative interest, for recent bank failures have revived the demand for a national currency, and for a revision of our banking legislation. It may, also, be said that the drift of our legislation has been for years towards a system of national currency. Meanwhile the powerful and conservative influence of our banking institutions is opposed to the Government assuming the sole right to issue a paper currency. And not the banks alone are found in opposition. Many are afraid that if this power were given to the Government it would be grossly abused. It would be so easy, it is contended, to borrow from the public by simply issuing a quantity of paper, practically costing nothing, that few Governments have sufficient self-control and political virtue to refrain from over-issues when sore pressed for funds. This objection would be well taken, were it proposed to issue an inconvertible paper currency; but would not apply to a currency readily convertible into specie. It may also be pointed out that it is not necessary that an issue of national currency should take place in exchange for specie; it might be circulated through the agency of banks, the banks receiving the notes in exchange for a deposit of Government securities of a greater or less amount.

There are others who object to the withdrawal of bank notes on the ground that national currency would not be sufficiently "elastic" for the varying wants of the trading classes.

At certain seasons of the year, it is urged, there is a demand for increased banking accommodation to move the crops and perform other services incidental to an increased trade. This accommodation, it is said, can best be given by means of an

increase in the issue of bank notes. The banks being left free to issue their notes at pleasure, can satisfy the wants of merchants, traders and speculators during these seasons of commercial activity. But had we a national currency, an increase of notes could be obtained by the banks only by buying them with their resources, so that the banks would have to call in their loans in one quarter, to lend them in another. In this there would be no increase of accommodation to the public. As the demand for increased accommodation is generally temporary, there is necessarily a surplus of currency after the demand ceases, and this surplus under our present system finds its way back to the banks in the form of deposits, repayment of loans, etc. Bankers then, under a free-banking system, advance the additional currency needed by traders and others during busy seasons, in the full expectation that after a short time their notes and the resources to meet them will flow into their coffers, until a fresh demand arises for another increased issue. A bank that can issue notes, only by first buying them with gold, or depositing securities, is not likely to make an effort to increase its issues; so that the mercantile classes, under a national currency, at certain seasons of the year, would find themselves seriously hampered in carrying on their business.

In reply to this, the strongest objection that can be urged against a purely national currency, it has been said that the same objection was raised against the United States national currency; but the logic of events has shown that no serious difficulty or inconvenience is experienced by the trading classes of the United States during busy seasons. When, in the fall and winter, the crops have to be taken to market, instead of bank notes, short-date bills of exchange are used, and no difficulty in consequence is felt. Besides, the temporary demand for an increased accommodation may be met by a freer use of cheques and other forms of banking credit. Those that advocate the utmost freedom in the issuing of bank notes to meet the requirements of trade, generally contend that when these notes are readily convertible, no more will stay in circulation than the wants of the community demand. Such is the view

of one school of thinkers, of which Prof. Bonamy Price was an ornament. On the other hand, good authorities like Prof. Jevons and Francis A. Walker, think that inflation is possible, even when notes are readily convertible, and that the right of banks to issue freely has frequently been the cause of speculation, inflation, over-trading, and other economic evils. Between such authorities it is prudent not to express an opinion, but I am disposed to think that the facts are with Jevons and Walker, although this is an open question in political economy.

I refrain from entering into the discussion of the right of a bank to *coin* notes, as John Law expressed it, or the right of the public to reap the profits arising from the circulation of a paper currency. It appears to me that there is no abstract or absolute right one way or the other. Such questions as the form or nature of a currency, who shall issue it, and who shall derive the profit from its circulation, are matters of expediency. The principal objects to be attained are absolute security for holders of the currency, and adaptability to the varying wants of the community.

To conclude, our system of banking has been conducted with considerable prudence, although rash and ill-advised ventures—not to use harsher terms—are by no means uncommon in our banking history. Free banking has not worked so well in Canada as in Scotland; and, in consequence, we have not the same confidence in Canadian bank notes that a Scotchman feels in the notes of the banks of his own country. On the other hand, there have been relatively few excesses, such as characterized banking in the United States prior to the introduction of the National Bank System.

Whether Canadian banks have unduly encouraged speculation by an over-issue of notes, and too free discounting and loaning, is open for discussion. Certainly their sins in these directions are not very heinous.

With respect to "elasticity," our banks satisfy the public requirements fairly well—better probably than a purely national system would do.

The great defects of our system—defects which will probably

lead to its serious modification, if not to its abolition, is its failure to inspire the public with full confidence in the ready convertibility of the bank issues—and the insufficient security possessed by shareholders and depositors against fraud and mismanagement.

The Canadian people, scattered as they are over such an immense area of territory, demand for commercial purposes a currency which will be taken without doubt or hesitation from one end of the Dominion to the other. Such a bank currency we have not—such a currency the State alone can supply, and ere long probably will, in response to the demand of public opinion, which on this question is rapidly ripening. But that such a currency will be modelled after the American is not at all likely, nor indeed is it desirable.

# APPENDIX.

## Note A.

The reason generally assigned for giving note-holders a first lien on assets is, that bank notes, although not legal tender, are taken in payment of debts by a great many people as a matter of necessity. Theoretically, no one is compelled to accept a Canadian bank note ; practically, notes on banks of supposed solvency are accepted as freely as gold or silver. On the other hand, no one is compelled theoretically or practically to deposit his surplus capital in a bank. It is entirely a matter of choice with the depositor whether he places his money in a bank or invests it some other way. This is the usual argument for preferring note-holders before other creditors. Against this may be quoted the following from the recent report of the Comptroller of the U. S. Currency: "The issue of preferred notes . . . would probably cripple fatally the general credit of the bank with prudent depositors. . . It is much more important to the banks as a body to retain and augment their deposits than to acquire the power to issue more currency, and the public have even a greater interest than the banks in the preservation of this condition of things, because the credit that attracts deposits is always better founded than that which floats currency, and is also more jealously guarded by the banks enjoying it, and is therefore less likely to be abused. It is, indeed, doubtful whether any really strong and prudent banks would like to risk their credit with depositors by issuing notes as a first lien on their assets. . . . In times of panic now banks (American) have to take care of their depositors only, . . . but when there is no special security behind these notes the case will be very different ; every rumor of monetary trouble will bring both note-holders and depositors clamoring for payment, and just when there is most need of money to pay them with, the currency will be contracted by the discredit of national bank circulation." (Pages 123-4.)

It can scarcely be said that our experience of the first lien principle has been such as to fulfil the forebodings of the Comptroller. It is true that depositors have lost heavily in some instances, but it is equally true that "strong and prudent" banks have experienced no difficulty in securing very large deposits in spite of the operation of the first lien principle.

## Note B.

The following from Laughlin's recent manual on Political Economy, will explain why banks in certain large cities require to maintain a larger reserve than fifteen per cent. of their deposits: "Certain cities named by Congress are called reserve cities, and all banks in these places are required to keep a reserve on hand equal to twenty-five per cent. of their deposits. Banks outside of

these cities (known as 'country banks') need keep a reserve of only fifteen per cent. of their deposits. Then the country banks may put three-fifths of their reserves on deposit in some bank in a reserve city; and banks in a reserve city may keep one-half of their reserves in a bank in New York city, the place of the central reserve. (*Note.*—An Act has just been passed by Congress to establish other central reserve cities)." (Pages 341, 342.)

### Note C.

Referring to the difficulty of obtaining bonds as a basis of national bank circulation, the Comptroller remarks: "One effect of this condition of things is to make the obligation to deposit bonds a serious obstacle to the formation of new banks in the sections where they are most needed, and to the increase of capital on the part of those banks of which the capital does not already exceed $150,000.

"The public needs and demands a continual increase of banking facilities, and to supply those facilities it is necessary to have not only more banks, but banks in a greater number of localities, and also some increase of capital among banks previously established.

"The need of such increased facilities is co-extensive with the country, but it is most pressing in those sections where the growth of population and the expansion of industry are year by year outstripping the measure of accommodation afforded by local capital.

"To such communities the national bank system affords opportunities otherwise unobtainable for bringing to the development of their resources supplies of capital from the remote centres of cheap and abundant money; hence, any obstacles to the growth of this system in our newer States and Territories is a more serious matter than it is elsewhere.

"Another effect of the laws as they now stand is to deprive the national bank circulation of the little elasticity possible to it, because the volume of this circulation varies with the amount of bonds held by the banks, and not only are bonds too scarce and dear to be freely bought and sold, but the inducement to banks to reduce their holdings of bonds to the minimum prescribed by law is constant and of growing intensity, while there are no inducements to an increase of such holdings; consequently there is neither elasticity nor steadiness in the volume of bank notes, but only a continuous contraction of circulation that year by year more than overcomes the annual expansion due to the formation of new banks, and keeps the public mind in a state of feverish anxiety, always easily excited into alarm.

"Still another effect is to render the banks very sensitive to every system made towards reducing the bonded debt of the Government." (Page 125, *Report.*)